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DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date 11-17-99

Surname [REDACTED]

000

Date: SEP 01 1999

Contact Person: [REDACTED]

I.D. Number: [REDACTED]

Telephone Number: [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were organized as a limited liability company under the laws of [REDACTED] on [REDACTED]. You have four Members. Each of your Members is exempt from federal income tax under section 501(c)(3) of the Code and serves as the parent entity in a hospital system. Each of your Members acts on behalf of a hospital which is the primary entity in its health care system. Your Members are [REDACTED] and [REDACTED]. You are controlled by your Members through their ability to appoint the members of your Board of Governors.

Your Members' hospital systems are operated independently of each other and are not structurally related. However, your Members are all parties to an Operating Agreement with you. You provide services to your Members' hospitals pursuant to the terms of the Operating Agreement.

In your attachment to Form 1023, you state that you provide Members with an exclusive regional network; (ii) provide a mechanism for the collection and assimilation of data to enhance the ability of the Members to measure and improve the quality of care, and to provide a mechanism for the dissemination of such data and information to health care consumers and purchasers (including, without limitation, third party payors, including governmental and non-governmental payors by or through Members); (iii) provide physician practice management services to physicians, medical groups, and other physician organizations affiliated with [REDACTED]; (iv) provide for the coordination of clinical and educational activities between health care professionals in the regions served by Members, as well as the development of specialty services utilizing purchasers on a regional basis, by providing purchasers with high-quality, accessible services at reasonable prices.

Furthermore, through your [REDACTED] you plan to integrate physicians with the affiliates of the Members by coordinating hospital/physician relationships among

You will also have an [REDACTED] that will provide competitively priced and operated physician practice management support to group practices, individual physicians, individual Practice Associations (IPAs), and other physician service delivery mechanisms a have been agreed upon by the Members. Practice management serves may include (i) provider contract negotiation and administration; (ii) Medicare risk management; (iii) management information systems development, implementation, and maintenance; (iv) medical management, including claims administration, utilization and case management, quality assurance and risk management, and physician credentialing and recruitment; and (v) support services, including nursing, billing, collection, and accounting.

In addition, you plan to have a [REDACTED] Division that is responsible for identifying and issuing non-binding recommendations to your Board of Directors relating to operations or objectives which your Members may desire to conduct. The [REDACTED] Division will also be responsible for implementing such recommendations. [REDACTED] Division activities may include, but are not limited to, the establishment of mechanisms or entities to enable and encourage the efficient, coordinated, and consolidated joint operation of operational support services, including laundry, purchasing, and similar services that are presently utilized by each Member.

You will have a [REDACTED] Division that shall establish and operate a mechanism for the coordination and sharing of experience and the exchange of information between the Members and their respective staffs. You state that this Division shall work to develop and implement standards, protocols, and other means by which each Member can establish and maintain high standards of care and service to the communities that they serve, and enable the strengthening of each Member through the sharing and communication of particular fields of expertise of each Member. This Committee shall be responsible for the development and implementation of a system of standards and benchmarks to enhance your ability to assist your Members in improving the quality of care delivered at their facilities.

In a letter dated [REDACTED], you state that you have no authority to engage in the following activities:

- 1) Establish budgets for each participating member, including responsibility to establish budgets as well as approve major expenditures, debt, contracts, managed care agreements and capital expenditures;
- 2) Monitor and audit each participating member's compliance with your directive;
- 3) Direct that services be undertaken or not undertaken by your members;
- 4) To hire and fire personnel;
- 5) Grant hospital staff privileges;
- 6) Set or approve fees and prices;
- 7) Buy assets for and sell assets of participating members; and
- 8) Reallocate income among the participating members to balance income and expenses to assure financial integration and achieve mutual objectives.

In your letter you also explain that many of the services you offer are in furtherance of the promotion of health because you will have the ability to reduce duplication and promote efficiency among your members. By sharing resources, you will benefit the public by increasing the resources dedicated to patient care. You also explain that the provision of administrative and management services to physicians at fair market value promotes health because it allows physicians to serve more consumers and better ensure that the health care needs of the community are being met. Your ability to offer a variety of payment options furthers the promotion of health by allowing your members to spread risk across a wide spectrum and increases the accessibility of affordable health care services.

Your Operating Agreement expressly provides that you shall be the preferred negotiator and executor of managed care contracts for your members. Accordingly, you have established a Division that is vested with the authority to contract with third parties, including purchasers of health care services, on behalf of your members. Nevertheless, you state that each member will individually negotiate certain terms of the managed care contracts that you secure. Specifically, each member will negotiate its own prices with third party payors, for fee-for-service, per diem, DRG or percentage of charge contracts. You members will, however, share information, to the extent it is necessary, in order to respond to a purchaser's request for a capitated arrangement.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for charitable, educational or scientific purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

Rev. Rul. 69-545, 1969-2 C.B. 117, recognizes that the promotion of health is a charitable purpose within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 78-41, 1978-1 C.B. 148, concludes that a trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital is operated exclusively for charitable purposes and is exempt under section 501(c)(3) of the Code.

Providing management and consultants' services to other, unrelated exempt organizations for a fee sufficient to produce a small profit does not further an exclusively exempt purpose. See BSW Group, Inc. v. Commissioner, 70 T.C. 352 (1978).

An organization providing laundry services on a centralized basis to exempt hospitals does not qualify for exemption under section 501(c)(3). See HCSC-Laundry v. United States, 450 U.S. 1 (1981).

Section 513(e) of the Code provides that in the case of a hospital, the term "unrelated trade or business" does not include the furnishing of one or more of the services described in section 501(e)(1)(A) to one or more hospitals if such services are furnished solely to such hospitals which have facilities to serve not more than 100 inpatients, such services, if performed on its own behalf by the recipient hospital, would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption, and such services are provided at a fee or cost

which does not exceed the actual cost of providing such services.

In Geisinger Health Plan v. United States, 30 F.3d 494 (3rd Cir. 1994), the court recognized that an organization may qualify for exemption based on the integral part doctrine, which arises from an exception to the "feeder organization" rule set forth in section 1.502-1(b) of the regulations. The exception provides that if a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with the parent organization.

The court also noted that an entity seeking exemption as an integral part of another cannot primarily be engaged in activity that would generate more than insubstantial unrelated business income if engaged in by the other entity. In this regard, the court followed the reasoning of section 1.502-1(b), which contains an example of a subsidiary organization that is not exempt from tax because it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business if regularly carried on by the parent organization. One example cited is if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization it is not exempt because such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the origination is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.

Accordingly, the court in Geisinger determined that application of the integral part doctrine requires at a minimum that an organization be in a parent and subsidiary relationship and that it not be carrying on a trade or business which would be an unrelated trade or business if regularly carried on by the parent.

As demonstrated by Geisinger, the courts have been clear that exemption under section 501(c)(3) of the Code is not generally available where an organization is established to provide corporate services to unrelated exempt organizations, other than through the application of section 501(e) of the Code for cooperative hospital service organizations. See BSW Group, Inc., *supra*, and HCSCLaundry, *supra*. Furthermore, exemption under the integral part doctrine requires a parent and subsidiary relationship and the absence of unrelated trade or business. See Geisinger, *supra*, and Rev. Rul. 78-41, *supra*.

You appear to be providing corporate services to unrelated exempt organizations without establishing that you satisfy the requirements of 501(e) of the Code. Further, the integral part doctrine does not apply to you because you have not established a parent and subsidiary relationship among your members. Also, you provide management, administrative and support services to physicians in the same manner as a business for profit.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also

[REDACTED]

have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the Ohio EP/EO key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
Attn: OP: E: EO: T: 4  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

*Marvin Friedlander*

Marvin Friedlander  
Chief, Exempt Organizations  
Technical Branch 1

cc: [REDACTED]

OP: E: EO: T: 4  
[REDACTED]  
[REDACTED]

OP: E: EO: T: 1  
*Friedlander*  
[REDACTED]  
[REDACTED]